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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 552.

THOMAS J. O'NEILL,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

MONROE GOLDWATER,
Counsel for Petitioner,
No. 60 East 42nd Street,
New York 17, N. Y.

GUSTAVE SIMONS,
H. WILLIAM CALLMANN,
Of Counsel.

THE COURT PRESS, N. Y. C.

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To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner, Thomas J. O'Neill, hereby respectfully requests this Honorable Court to issue writ of certiorari to the United States Court of Appeals for the Second Circuit to review the decision and judgment of that Court which affirmed the decision and Order of the Tax Court of the United States in this proceeding.

Opinions Below.

The opinion of the United States Court of Appeals for the Second Circuit (R. 56-61) is reported in 170 F. 2d 596.

The findings of fact and memorandum opinion of the Tax Court (R. 13-19) are unreported.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on November 12, 1948 (R. 63).

The jurisdiction of this Court is invoked under Section 1254 of Title 28, United States Code.

Questions Presented.

The questions presented are as follows:

First: Whether, in the absence of a tax motive, a stockholder's loans to a wholly-owned corporation, dealing in real estate over a period of twenty-four (24) years, may be disregarded as such merely because there is no affirmative demonstration of a "business purpose" in choosing the corporate form?

Second: Whether the "business purpose" test is not met, if the corporate form was used to avoid obtaining the signature of the stockholder's wife because of her dower rights?

Third: Whether a real estate corporation, buying and selling real estate, receiving rent and proceeds of sales, taking title to real estate, paying business expenses and issuing financial statements and balance sheets, is not carrying on business within the meaning of the law.

Statutes Involved.

The statutes directly involved are Section 23(g) and (k) (26 U. S. C., 1946 ed., Sec. 23) and Section 117(b) of the Internal Revenue Code (26 U. S. C., 1946 ed., Sec. 117).

Summary Statement of Facts.

The Court of Appeals reviewed the Tax Court determination, pursuant to Section 36 of the Act of June 25, 1948, Public Law 773, 80th Cong., 2d Sess., amending Section 1141(a) of the Internal Revenue Code in such manner as in effect to expurgate the *Dobson* decision—so far as it pertains to the scope of review exercised by the Courts of Appeals over the Tax Court—from the general body of federal tax law. Its findings of fact may be summarized as follows:

The petitioner, a practicing lawyer, deducted from his income tax return, for the calendar year 1941, as bad debts, the full amount of the unpaid remainder of advances he had made over many years to two (2) corporations, wholly owned by him, which were dissolved in 1941. The Commissioner disallowed these deductions as bad debts but, treating the advances as capital investments, allowed the deduction of only one-half of the unpaid remainder as capital losses and determined a deficiency of $16,777.05, in the income taxes of the petitioner (Section 23(g) of the Internal Revenue Code, 26 U. S. C. Sec. 23(g)).

Two wholly-owned corporations are involved. In 1917 the petitioner organized the 123 Locust Hill Avenue Company, Inc., the major debtor, with an authorized capital of $2,000 which was paid in. In 1936 he organized the 123 Hillcrest Avenue Corporation with an authorized capital of $1,000 which was paid in. Both corporations were dissolved in 1941.

The petitioner received no note or other evidence of indebtedness.

Tax returns for the two (2) corporations were regularly filed. In addition, the Tax Court found

and the Court of Appeals quotes from its findings (R., 15, 58):

> "Working papers of accountants and financial statements were prepared from lists of receipts and disbursements for the account of the corporations, and check books and bank statements of the petitioner. Balance sheets and other financial statements of the corporations listed the advances made by the petitioner as loans payable. The amounts were referred to as such during conversations between petitioner and accountants employed by him. Checks received by the corporations from the sale of property were endorsed to petitioner and thereafter treated as repayments of loans."

The petitioner furnished what money was needed, in addition to the $3,000 of authorized capital which he had paid in and the Tax Court found, and the Court of Appeals repeats, that "amounts so paid by Petitioner were regarded as advances to the corporations" (R. 15, 58).

Both corporations were organized primarily to hold the title to real estate and to enable the petitioner to sell it, or otherwise deal with it, without his wife's signature to deeds or other documents.

The Court of Appeals stated that no thought of its effect upon taxation prompted petitioner's election of the way he chose to deal in, or invest in, real estate.

Decision of the Court of Appeals.

The following language from the Court of Appeals opinion fairly summarizes its interpretation of the Tax Court decision and its own holding:

"It is apparent that the Tax Court did not re-

gard these corporations as non-existent for tax purposes and bypass them entirely in redetermining the petitioner's income taxes for the year here involved. It gave effect to their dissolution in the taxable year as the event which made it possible to determine gain or loss on the theory that the petitioner's advances for their account were contributions by him to their capital. Nevertheless the Tax Court must be assumed, though it did not quite say so in words, to have refused to treat the two corporations as entities so separate and distinct from the petitioner that he could create debts payable by them to him by advancing money for their use with the intent that those advances should be repaid by them.

"For, ordinarily, this intent to make the advances as loans would fix their status as such. See *Edward Katzinger Co.* v. *Commissioner,* 7 Cir., 129 F. 2d 74; *Van Clief* v. *Helvering,* App. D. C., 135 F. 2d 254; *Fairbanks, Morse & Co.* v. *Harrison,* 63 F. Sup. 495. But that presupposes that the borrower, if a corporation, serves some business purpose substantial enough to make it for tax purposes something more than another name for the lender" (R. 58, 59).

* * * *

"We think it is well within the 'unusual' category above mentioned and that the Tax Court did not err when it treated as one for debtor and creditor purposes the man who provided the advances and his corporations which did no recognizable business of their own" (R. 61).

Specification of Errors to be Urged.

The Court of Appeals erred:

First: In holding that in the absence of a tax motive, a stockholder's loans to a wholly-owned corporation, dealing in real estate over a period of twenty-four (24) years (and to the second corporation) may be disregarded as such merely because there is no affirmative demonstration of a business purpose in the use of the corporate form.

Second: In holding that the use of the corporate form, in order to avoid delay of real property sales in obtaining the signature of stockholder's wife because of her dower rights, is not a business purpose.

Third: In holding that a real estate corporation, buying and selling real estate, receiving rent and proceeds of sales, taking title to real estate, paying business expenses and issuing financial statements and balance sheets, did not carry on business within the meaning of the law.

Reasons for Granting the Writ.

The decision of the Court of Appeals erroneously applies and is also in conflict with the decision of this Court in *Moline Properties, Inc.* v. *Commissioner*, 319 U. S. 436.

a. The petitioner urges that in the absence of sham it is an unwarranted extension of any doctrine found under any authority, be it under *Gregory* v.

Helvering, 293 U. S. 405, or *Higgins* v. *Smith*, 308 U. S. 473, to require the demonstration of a "business purpose" in order to recognize the reality of a corporation honestly maintained over a period of twenty-four (24) years.

The Court of Appeals has found that the petitioner organized the major corporation in 1917 and "* * * that no thought of its effect upon taxation prompted his selection of the way he chose to deal in, or invest in, real estate * * *", and it further was found that "balance sheets and other financial statements of the corporation listed the advances made by the Petitioner as loans payable" (R. 60-61, 58).

With these conclusions of fact the petitioner is in complete accord.

May the Commissioner or a Court then test the business judgment of the petitioner in selecting the corporate form?

The Court of Appeals states that "the decisive question is whether the corporations were created to, or did, in fact serve a recognizable business purpose".

The Court of Appeals cites two decisions of this Court (R. 60, 61).

The first is *Moline Properties, Inc.* v. *Commissioner*, 319 U. S. 436; but there the Supreme Court merely held that the taxpayer was bound by his election to use the corporate form. The case is no authority for an opposite conclusion.

True, the Supreme Court discussed the circumstances under which the corporate entity might be disregarded. But the *Higgins, supra*, and *Gregory, supra*, cases, cited by the Supreme Court in that connection, were both obviously cases of unreality and

sham. This Court, in its *Moline* opinion, characterizes both of the aforementioned cases thus:

> "* * * in such situations the form is a bald and mischievous fiction."

The second decision of this Court, cited by the Court of Appeals is *Higgins* v. *Smith*, 308 U. S. 473, and this authority has been clearly distinguished from this case in the preceding paragraph.

(b) If, under the facts of this case, "business purpose" must be demonstrated, this test is clearly met.

In analyzing the distinction taxwise between a wholly owned corporation and its owner this Court established the following principle:

> "Whether the purpose be to gain advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity" (*Moline Properties, Inc.* v. *Commissioner, supra*).

According to the Court of Appeals, the "only disclosed reason" for the organization of the corporations and for their being kept in existence until they were dissolved was to make it unnecessary for the petitioner to procure, from time to time, his wife's signature to some papers (R. 60).

As far as the facts are concerned, the petitioner must accept the foregoing statement of the Court of

Appeals, although he, as an attorney, was well aware of the limited liability connected with corporate form and expressly so testified:

> "In other words, as to those things I was to advance the money as a loan to my own corporation, which I was controlling, which looked safe enough to me" (R. 51, 52).

However, the reason for the organization of the corporations, referred to by the Court of Appeals, clearly represents the equivalent of business activity within the meaning of the *Moline* case.

Under New York State law, if the vendor of real property is a married man, his wife must join in the execution to exhaust her inchoate right of dower, providing the property was acquired before September 1, 1930 (Sections 190, 207 New York Real Property Law; Harvey, "Title Closing," second edition, New York 1946, page 120).

Accordingly, a purchaser of real estate cannot be compelled to complete his purchase or accept the title if there is an encumbrance on the property which the vendor cannot or will not remove, and which the purchaser cannot, himself, remove by an application of the purchase money. Inchoate rights of dower are in the nature of such encumbrances (Maupin, "Marketable Title to Real Estate", third edition, 1921, pages 851, 855).

When the petitioner selected the corporate form in order, among other motives, to facilitate real estate transactions with regard to his wife's dower rights, this purpose of the petitioner is, contrary to the Court of Appeals' assumption, clearly the equivalent of business activity within the meaning of *Moline Properties, Inc.* v. *Commissioner* (*supra*). Except for

mere formalities, it is difficult to see what petitioner could have done in 1917 other than he did do when he adopted the traditional corporate form for trading in real estate. His consideration of the very real complications connected with his wife's dower rights indicates the *reality* of the corporations and refutes conclusively the argument of sham and unreality.

c. Furthermore, this purpose of the petitioner *was followed by the carrying on of business by the corporations.*

The facts found by the Court of Appeals reveal;

that the corporations received rent;

that they received proceeds of sales of real property;

that they took title to real property;

that they paid expenses incident to the acquirement, ownership and sale of real property;

that they received checks and endorsed same to the petitioner in partial repayment of his advances;

that they prepared financial statements showing receipts and disbursements;

that they prepared balance sheets.

The corporations dealt in real estate and only in doing so suffered the substantial losses which gave rise to this litigation.

Thus, both alternative conditions for the recognition of the separate taxable entity of a corporation, as established by this Court in the *Moline Properties,*

Inc. case, have been clearly complied with in this case, viz., the petitioner's *initial purpose was the equivalent of business activity,* and the corporate organization was followed by the *carrying on of business,* which resulted in the worthlessness of petitioner's loans.

The first case cited in the Court of Appeals opinion on the sole issue was *Commissioner* v. *National Carbide Corp.,* 2 Cir. 167 F. 2d 304. Upon information and belief, this Court granted a writ of certiorari in that case and it is presently on review before this Court. It would be manifestly unjust for petitioner to be foreclosed from further consideration of this case if *Commissioner* v. *National Carbide Corp., supra,* is under review by this Court. Granting of this writ is the only effective means of preserving petitioner's equities.

The unwarranted extension of the doctrine of the *Moline* case to achieve the opposite result of piercing rather than upholding the corporate entity, in a case with no motive of sham or tax avoidance, would mean that a taxpayer organizing the traditional real estate corporation would be faced with the alternative of having the entity recognized under the *Moline* case if that would hurt him taxwise and having the corporate entity disregarded, as well, if that would hurt him taxwise. The possibility of this unhappy alternative is recognized quite explicitly in the opinion of the *Moline* case, but was very carefully restricted to instances of sham and unreality and never intended to be extended to a twenty-four-year-old real estate corporation organized with no tax motivation and in perfect good faith. The uncertainties and dangers of

such a radical extension and misunderstanding of the *Moline* doctrine suggest review by this Court.

If the decision below, so obviously in conflict with the principles enunciated by this Court, be permitted to stand, the legitimate business operations of many corporations will be open to attack. The doctrine of disregard of corporate entity would be applied and extended far beyond the limitations stated by this Court.

Wherefore, your petitioner respectfully prays that a Writ of Certiorari should be granted.

Respectfully submitted,

MONROE GOLDWATER,
Counsel for Petitioner.

GUSTAVE SIMONS,
H. WILLIAM CALLMANN,
Of Counsel.